NOTES

THE CLASSIFICATION OF FINANCIAL INSTITUTIONS.

During recent years there has been a great growth in both the number and the varieties of institutions of a financial nature. Especially has this been true during the war. The growth has been both progressive and cumulative. To use a well-recognized illustration referring to a somewhat earlier period, the trust company had its inception in connection with insurance business, particularly in connection with such kinds as title insurance. As the years went by, insurance and fiduciary business were increasingly recognized as separate and distinct, so that roughly by the time of the Civil War they were fairly well separated. Subsequently too, a change became noted in the character of the fiduciary business of the trust company. Whereas the earlier trusts had been largely individual in nature, with the rise of the corporation various corporate trusts developed and became of increasing importance. Particularly of course was this the case in the larger centers, so that in a considerable number of cases the corporate trust business has come to overshadow the individual trust business. At the same time, moreover, it has been found that banking is a kind of natural adjunct to trust business and in all but a few states banking—including the reception of both time and demand deposits—is now combined with trust business. Commercial banks likewise have added trust departments, so that the modern department store of finance is now definitely with us.

While this movement of integration has been taking place, a movement toward specialization has developed in certain directions. Particularly is this the case with the newer financial institutions. Institutions conducting business of one kind or another which is related to finance have multiplied. The result is that the field at present presents a very complex appearance. In particular the problem arises of classifying the newer institutions and determining exactly where they "fit into" the existing financial structure. This problem perplexes the student who is attempting to describe the field of banking and to take cognizance of the newer developments. It is well illustrated in considering the ordinary discussions of the field of banking. The older tendency has been to neglect these institutions entirely and confine the discussion to the traditional banking field, discussing very largely commercial bank-

ing and mentioning savings banking incidentally. On the other hand those writers who have attempted to envisage the newer institutions also have been confining their efforts largely to mere enumeration and description of the operations of these institutions. Little attempt has been made to definitely relate them to other banking institutions or to consider their exact place in the realm of finance.

In considering the great number of organizations in the general field at the present time, it is important to remember that the significant thing is the type of operation or operations in which they are engaged, not the total business which any given organization does. One organization may do several types of business which fundamentally are unrelated. In short, attention should be directed not to structure, but to function. We should pay attention to each type of operation, for only in this way is it possible to obtain a clear understanding of the field.

Considering the matter from this point of view, we may suggest a definite method of classifying these institutions. At present the classification is largely according to whether the institution is, (1) public or private in nature, and (2) whether it belongs in the commercial or the investment field. From the point of view of understanding the variety of institutions which have arisen, a third classification is highly desirable, namely, according to method of operation. By this means we also are enabled to see definitely the relation which the financial institutions bear to the traditional banking field and at what points they touch upon that field.

In considering the method of operation, we must, however, exclude trust or fiduciary business. This is essentially a purely legal category, which is auxiliary to and aids the financial aspect. Bearing this in mind there are three general methods of operations. The first is by means of deposits. That is to say, funds are assembled by an agency, generally called a bank, from a series of individuals or enterprises, whose interest as depositors is continuous, and these assembled deposits are applied by the agency in various directions. The agency or organization stands as intermediary between those from whom it receives deposits and those to whom it makes loans or in whose obligations it invests, but it itself continues at all times to have dealings with both classes. Distinct from this is operation by means of mediation. Certain institutions are engaged entirely in merely purchasing and selling. Each purchase and sale is distinct and the relation between the purchaser and the seller closes at once. The third method is operation by means of the application

of the suretyship principle in this field. That is to say, no funds are supplied and no obligations are dealt in, but credit is merely guaranteed or insured. In case the original debtor fails to make payment, the organization which guarantees or insures the credit, agrees in his place to make good. This may be done in one of several ways, but the essential principle is the same in all cases.

Further description of each of these three fields is desirable. The deposit principle is, of course, applicable in a number of ways. The ordinary bank provides the major illustration, but, on the other hand, the co-operative feature may be introduced. This is illustrated in the case of the mutual savings bank, in which there is lenders' or savers' co-operation. This may be carried one step further and co-operation among borrowers may be introduced. In other words, the building and loan association, the savings and loan association and the credit union all fall within this general field. It should not be forgotten, of course, that the commercial banks, in operating by means of the deposit principle, creates deposit currency, at the same time that it serves as an agency for the supply of funds.

Operation by means of the mediation principle is of several distinct classes. Most simple is pure brokerage, in which the securities, paper, or other obligations are merely sold on commission. In this case the institution supplies no funds. Purchase of obligations and resale of them, but without endorsement, constitutes a second class. Here of course, the institution does supply funds. The commercial paper dealer or the ordinary investment banker well illustrates this method of operation. The institution may go one step farther. It may purchase obligations and resell them with its own endorsement as, for example, in the case of the cattle loan company. Finally, the organization may purchase securities and resell, not these obligations, but its own obligations instead, perhaps using the other obligations which it has purchased as collateral. This last type is illustrated by the discount company which purchases receivables, as well as by the real estate mortgage banker and by the Edge Law corporations. The obligations which it resells may be in the nature, for example, either of collateral trust notes or of debenture bonds.

It should be noted that the deposit method of operation and the mediation method of operation (including the four subtypes) may be applied either in the commercial or in the investment sphere or in both. The cattle loan company, for example, makes feeder loans which fall

definitely in the commercial sphere, while at the same time it makes stocker loans which fall within the investment sphere. Similarly the commercial paper house in many respects, perhaps in most, is the counterpart in the commercial sphere of the investment banker in the investment sphere. Furthermore any single house may operate by means of two methods, conducting part of its business by one means and part by another. The investment trust, for example, may either purchase securities and resell these with indorsement, or it may sell its own obligations instead. Likewise an organization financing sales on the instalment plan, such as in connection with retail sales of automobiles, furniture, and pianos, may obtain part of its funds by means of collateral trust notes and part through the issue of debenture bonds. Finally, it should be borne in mind that the growth of these financial institutions has been in considerable measure along the line of specialization of industries. Thus we have, for example, automobile finance companies, real estate mortgage bankers, cattle loan companies, etc. Some further specialization exists according to type of business. Thus we have commercial paper dealers, acceptance dealers, and investment bankers.

The third method of operation is by means of the principle of suretyship. This is a more recent development, in the United States at least, and is more in process of development than is the case with certain of the other methods indicated above. As already indicated, it is applied in several distinct ways. The acceptance house abroad, or in the United States the bank which accepts and thereby creates bankers' acceptances, well illustrates one method. It does not in itself supply funds, of course, but merely creates its own obligation to pay, for which it expects to be put in funds, however, by the borrower prior to maturity. Suretyship may also be accomplished in another way. The credit insurance company stands ready to insure the accounts of merchants and to make good abnormal losses which occur. The difference from acceptance will, of course, readily be perceived, but at heart the two methods illustrate the application of the suretyship principle to the financial field.

The following table illustrates the classification suggested above of financial institutions according to method of operation. For the sake of convenience, commercial banking has been regarded as typified by the commercial bank and similarly with the other operating methods. It should be borne in mind, however, as indicated above, that the essential distinction is one of method of operation or function and not one of structure.

CLASSIFICATION OF FINANCIAL INSTITUTIONS ACCORDING TO METHOD OF OPERATION

Method of Operation	Commercial	Investment
Deposit	Commercial bank	Savings bank Co-operative institutions Savings and loan association Building and loan association Credit union
Mediation 1. Pure broker (sell on commission)	Foreign exchange broker Note broker	Stock broker Mortgage broker
2. Buy and sell without indorsement	Commercial paper dealer Acceptance dealer	Investment banker
3. Buy and sell with indorsement	Cattle loan company (feeder loans)	Cattle loan company (stocker loans) Investment trust
4. Buy and sell own obligations	Discount company—including company financing wholesale marketing of automobiles	Real estate mortgage banker—farm or urban Instalment financing company—including financing of retail sales of automobiles, furniture, pianos, books Investment trust
Suretyship	Acceptance house Credit insurance company	

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WAS DECONTROL OF SUGAR IN THE UNITED STATES ADVISABLE?

In his *American Citizenship and Economic Welfare* Professor Hollander reminds us that Dugald Stewart wrote to Lord Craig in 1794, "among all the interesting questions which have, during the last nine years, divided our political parties, I have never introduced the slightest reference to any of them excepting in the single instance of the African trade, on which I formerly expressed myself with some warmth—and even these expressions I dropped from my course, as soon as it became a matter of popular discussion."

Such isolation of the university economist from questions of dominant public interest and controversy is today almost as obsolete as the powdered wig. But in these days of active participation by economist and statistician in business and government, much may be accomplished in advancement of economic science if there is recorded for each concrete